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Analyzing the Efficacy of Early Retirement Incentives in the Private Sector

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13. ABSTRACT

Corporate financial stability has long been considered to be an essential feature of successful enterprise even in stable or growing economy. Financial crises and recessions set much higher requirements toward financial stability of the enterprise. In their search to regain stability and improve performance, companies utilize various operating and financing solutions. Among these solutions, an important role belongs to cost reduction initiatives such as early retirement incentives.

Early retirement incentives are considered to be an effective and humane measure of payroll costs reduction. Nevertheless, there is a lot of controversy regarding its actual efficacy. This research paper reviews costs and ramifications of early retirement incentives and their efficacy as compared to other cost-reduction options, and analyzes advantages and disadvantages of their implementation in order to conclude on their actual efficacy.

While early retirement incentives may have significant payroll-costs reduction potential, they are not focused, and their outcomes may vary greatly. Therefore, estimation of immediate financial effects of early retirement incentives and their unintended consequences is extremely challenging. Similarly, it is impossible to conclusively determine who benefits more from early retirement incentive programs—a company or its employees.

These facts drive to the conclusion that implementation of the early retirement incentives requires the most elaborate planning and execution in order to be effective, predictable, and safe.

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ANALYZING THE EFFICACY OF EARLY RETIREMENT INCENTIVES IN THE PRIVATE SECTOR

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TABLE OF CONTENTS

LIST OF FIGURES

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LIST OF TABLES

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– Laura Mason

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– Linda K. Cline

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I. INTRODUCTION/BACKGROUND

Under an early retirement incentive (ERI) program, employers offer eligible employees the opportunity to retire before meeting normal retirement criteria in exchange for a lump-sum payment and increased benefits over an extended period of time. After the program is announced, eligible employees usually have two to three months to make a decision whether to accept the offer (Hawthorne, 1993).

Although implementing an early retirement incentive program requires certain expenditures, they are normally outweighed by a number of factors, including:

- Reduced labor costs such as salaries, unemployment taxes, and social security taxes.
- Preservation of operating funds—retirement funds are paid out of the general account and do not affect the yearly operating funds of the organization.

Therefore, the only direct cost to the organization are the lump sum payments, and that cost is offset by the projected savings from the reduced workforce size. The companies consider early retirement incentives as a form of downsizing strategy aimed to improve the corporate financial performance. There are a number of possible drivers leading to a decrease in the workforce, including right-sizing the organization for anticipated market share, automation of certain labor functions, and a shrinking market sector or overall economic downturn. An economic recession is the most significant factor in an organization's decision to launch early retirement incentives programs.

Whatever factors drive the organization's personnel reduction, an early retirement incentive program is one option attractive to companies because of the voluntary nature of the action versus a non-voluntary, or lay-off, situation.

There may be unintended consequences that have significant impact on a company. For many organizations, downsizing has not been overly successful and has even led to serious problems. Early retirement incentive program, being a form of downsizing; have many significant differences from other more common forms of

downsizing such as layoffs. Some of these differences may be beneficial, as compared to layoffs; however, some of the differences represent a specific set of negative implications, which are extrinsic for layoffs. In light of mixed results, it is important to study reasons behind success or failure of downsizing and early retirement in order to understand whether such strategies are beneficial and how to implement them effectively.

A. RESEARCH QUESTIONS

Downsizing is one of the primarily types of cost-cutting initiatives during economical downturns. However, even in a growing economy, downsizing may be the primary tool used for organizational efficiency improvement (so called “leaning”), which was the case in the late 1990s and early 2000s. Early retirement incentive programs are often considered by managers to be one of the most effective forms of downsizing. Many researchers criticize early retirement incentive programs and downsizing as a performance improvement strategies and report multiple risks and inefficacy of such strategies (Snarr, 1995). Therefore, the purpose of the research is to provide analysis of early retirement incentive efficacy for the organizations in the private sector from a number of perspectives. In order to achieve this, the following research questions were formulated:

1. What are the ramifications of financial risks in terms of human resources financial costs when firms utilize early retirement strategies?
2. Are early retirement incentive strategies the most effective way to regain financial stability?
3. Who benefits more from early retirement strategies, management or employees?

B. STRUCTURE OF THIS RESEARCH

The paper is further structured as follows:

1. Chapter I provides introduction and background information regarding early retirement incentives.
2. Chapter II provides a review of the literature available regarding early retirement incentives.

3. Chapter III establishes the research framework and methodology.
4. Chapter IV provides an analysis of costs and risks associated with early retirement incentives, their impact on the corporate financial stability and analysis of other advantages and disadvantages of the early retirement incentive program
5. Chapter V summarizes conclusions and outlines recommendations for further research.

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II. LITERATURE REVIEW

In this chapter, existing literature on early retirement incentives is reviewed. First, early retirement incentives as a downsizing strategy and reasons behind their implementation are discussed. Next, perceived benefits of early retirement incentives according to recent studies will be outlined. Finally, major drawbacks of early retirement incentives will be discussed.

A. EARLY RETIREMENT INCENTIVES AS A DOWNSIZING STRATEGY

Over a decade prior to the global financial crisis breakout in late 2007 and early 2008, downsizing was one of the preferred solutions for organizations efficiency improvement in North America (Morris et al., 1999). Moreover, downsizing during this period became a norm rather than an exceptional practice used only by distressed organizations (Cameron & Smart, 1998).

After the recent financial crisis broke out and the vast majority of the economies entered into recession, downsizing initiatives became even more pervasive. The International Labor Organization (ILO) estimated that layoffs caused by the world-wide recession will reach 50 million by the end of 2009 (Mortished, 2009). Similarly, downsizing was a response of many organizations to the economic downturn in the late 1980s and early 1990s (Minda, 1997).

Despite their pervasiveness in recent decades, layoffs are still considered to be painful for all involved; laid-off staff, decision makers, and remaining employees. Therefore, a common initial step before implementing layoffs is offering a segment of the employees a benefit incentivizing voluntary separation, such as buy-outs or early retirement packages. Early retirement incentives programs became increasingly popular in the 1990s and were utilized by such prominent companies as General Motors, IBM, Polaroid, Sears, and Unisys Corp., to name few (Hawthorne, 1993).

Early retirement incentives, as a form of workforce reduction, are used to achieve immediate, short run savings in labor costs (Koeppen et al., 1990). A primary distinction

of early retirement incentives from layoffs, as was highlighted by Tomasko (1991), is that a layoff reduction approach is a “push” strategy, while early retirement incentives is a “pull” strategy of workforce reduction.

While early retirement incentive is rather a one-off solution, offered to a select group of employees for a limited time, many organizations have the ongoing early retirement plans incorporated in their Human Resource strategy. The policy is to achieve long-term cost savings from employee retirement before the age of 65 without their benefits impaired. In any case, both ongoing and one-off early retirement incentive programs have a number of perceived benefits, subject to inherent drawbacks, some are anticipated and some are often totally unexpected.

B. BENEFITS OF EARLY RETIREMENT INCENTIVES PROGRAMS

A number of factors make early retirement incentives an attractive downsizing strategy for the managers:

1. Such plans are considered by managers to be an efficient lever for organizations to reduce headcount and associated costs, and to streamline operations (Polisner, 1996).

2. Many find early retirement incentives to be much less harsh than layoffs, reducing impact on decision-makers, as well as limiting the morale impact on remaining personnel (Kets de Vries & Balazs, 1997). Therefore, early retirement programs are considered to be a humane way of headcount reduction (Paul & Townsend, 1992), which is relatively painless (Worth, 1995).

3. Traditionally, companies pay older employees higher remunerations than younger ones, while many believe that older workers’ pay rates may not be in line with their current job efficiency (Worth, 1995; Davidson et al., 1996).

4. Early retirement incentives often improve career opportunities for younger employees, which are less expensive and also usually require lower benefits payouts, especially with respect to health care (Mathys & Burack, 1993).

5. Majority of costs associated with early retirement incentives are charged to pension funds (Tomasko, 1991).

Based on these arguments, many managers believe that early retirement incentives plans are not only a quick way to reduce labor costs, but are less painful and have number of positive effects on the organization. However, Cameron (1994) compares them to "throwing a grenade into a crowded room, closing the door, and expecting the explosion to eliminate a certain percentage of the workforce." Cameron further explains that, "it is impossible to determine what institutional memory, and what critical skills will be lost to the organization when employees leave."

C. CRITICISM OF EARLY RETIREMENT INCENTIVES PROGRAMS

Despite outlined benefits of the early retirement incentives for employers and remaining employees, such programs are widely criticized from different perspectives. Critics of early retirement incentives challenge their perceived benefits and provide evidence of their negative effects, both anticipated and unintended.

1. Criticism of "Humaneness" and "Painless" Notions

First of all, many researcher's challenge the perception that early retirement incentives are a humane and painless approach to downsizing the workforce. Many proponents argue that employees who choose early retirement programs are wealthy enough to painlessly tolerate dismissal under early retirement incentive programs. However, Paul and Townsend (1992) provided evidence that employees who retired under early retirement incentive programs not only face serious boredom, but often experience severe financial problems, as well as personal psychological problems regarding values, self image, powerlessness, and security, which often result in a deep personal identity crisis.

Paul and Townsend (1992) also noted that, despite the notion that incentives programs are declared to have a voluntary nature, many individuals who choose to take early retirement often felt that it was involuntary. Therefore, contrary to the belief that early retirement incentives are a headcount reduction "pull" strategy, those who opt to retire under such programs often believe that they have made their decision because of "push" factors (Shultz et al., 1998). This notion was supported by the work of Gowan (1998), whose study on acceptance factors for early retirement programs revealed that 49

percent of respondents who had recently accepted an early retirement offer indicated that such a decision was not desirable for them. These findings suggest that decisions to retire early are more involuntary than they are often believed to be.

Despite the fact that early retirement incentive programs are typically advertised as voluntary, the individuals who were offered early retirement packages often feel they are being pressured to accept such offers and, in any case, feel that the offer conveys a message that they are not wanted in the company. Gowan also noted that perception of an early retirement offer being involuntary is particularly likely for individuals with low self-esteem. Those employees experience the same emotions that employees who were laid off experience and accordingly, believe they were forced to leave their companies involuntary.

2. Criticism of "Fairness" Argument

Many organizations raise salary of the employees annually. Accordingly, some managers believe that in many cases older employee's have higher remunerations, as compared to younger workers, due to longevity of their employment rather than due to higher job efficiency (Kanfer & Ackerman, 2007). Advocates of this notion support early retirement incentives as a strategy that eliminates this disproportion. However, this notion is also often criticized by the researchers (Davidson et al., 1996; McEvoy and Cascio, 1989; Waldman and Avolio, 1986)

The reason older workers are targeted for downsizing through early retirement incentive programs is based on the employment life-cycle theory. According to this theory, during an employee's career, his or her salary increases with age rather than with productivity. Accordingly, employees who are young or new to the organization have pay rates lower than their productivity and their older counterparts. Overtime, pay rate, and productivity become better aligned. However, as an employee becomes older and productivity begins to decline, his or her pay rate continues to rise. At some point, an employee's pay rate exceeds his or her relative productivity. Proponents of employment

life-cycle theory consider such situations to be operational inefficiency and, therefore, recommend its elimination through termination of the older employees (Worth, 1995; Davidson et al., 1996).

Employment life-cycle theory is common in business practice (Kanfer & Ackerman, 2007). Validity of this theory, the gradual reduction of productivity with age, was not confirmed by scientific research (McEvoy & Cascio, 1989). The research focused on meta-analysis of the articles for 22 years with a sample size of close to 40,000 in order to test the association between age and performance. The analysis found that these factors are generally unrelated. Moreover, according to researchers such as Waldman and Avolio (1986), there is evidence that performance increases with age, especially for professionals.

These findings provide a basis for researchers, who argue that early retirement incentive programs are a form of age discrimination, exploiting vulnerable position of older employees, who have limited options (Minda, 1997). Minda (1997) argues that even if the life-cycle theory is valid, dismissing older employees on the grounds that their pay rate is higher is unfair. Minda also argues that overpayment during the later stages of employees' careers compensate for early years of their employment, when these employees were underpaid, according to life-cycle theory.

While authors such as Minda claim that early retirement incentive programs are discriminative against older workers, other authors state an opposing view. These authors acknowledge that early retirement incentive programs are discriminating; however, they believe that they are discriminating against remaining employees. Most of the benefits paid under early retirement plans are withdrawn from the organizations pension funds, often from its surplus revenues. According to Hinerfeld (1992), these revenues should belong to all pension fund members, and the use of this fund to pay buy-out benefits to early retirement employees is unfair for the other employees.

Cases of early retirement incentive program unfairness were exposed by a number of lawsuits by employees who were not offered the early buy-out package. According to Snarr (1995), employees who choose to retire early, when early retirement incentive programs and corresponding benefits were unavailable, sued employers that announced

those programs after their retirement. Snarr also provided examples of lawsuits initiated by employees who retired under early retirement incentive programs that were less beneficial than subsequent programs announced by the same company.

3. Criticism of Early Retirement Incentive Programs' Social Expediency

Some of the researchers criticize early retirement incentive programs for being contrary to social realities, such as demographic dynamics and corresponding needs of the society.

Paul and Townsend (1992) provide strong evidence that North America (the United States and Canada) is facing a significant reduction in the labor market in future decades. Reduction of the labor pool will result in the shortage of workers on the labor market. Stein et al. (2000) also note that, due to current demographic dynamics, in the next decade employees of the pre-retirement age (over age 55) may exceed the number of young people entering the labor market.

The problem is focused in two areas. While duration of life increases and people preserve physical and mental capability to work longer, older workers choose to retire earlier either voluntarily or as a result of proposed early retirement incentive programs. (Woodbury, 1999). The laws repealing mandatory retirement at a certain age were passed in the United States in early 1990 because of negative demographic tendencies. The goal of these laws was to prevent further reduction of labor pool by promoting later retirement. However, these laws failed to reverse negative tendencies in retirement (Paul & Townsend, 1992) and many of the workers still choose to retire even before retirement age. According to Woodbury's research, performed for the National Bureau of Economic Research in the U.S., significant numbers of workers start retiring as early as at the age of 55, and by the age of 63, half of those who remained after 55 also retire (1999).

Accordingly, it becomes an important social and economical issue. Early retirement creates a large population that remains capable of working productively but becomes nonworking and therefore is supported by a diminishing working population (Stein et al., 2000). The labor force, which pays into public pension and health plans, diminishes. At the same time, the aging population, which receives benefits from these

plans for a longer period because of the increased life expectancies, continues to grow. These two factors are thought to contribute to the deterioration of the public health care and pension plans.

4. Strategic Fit Issues

Other criticism focuses on the impact to the organization. Some researchers provide evidence that early retirement incentives may be harmful for the organization from a strategic standpoint.

The major problem with early retirement incentive programs from a strategic perspective is the difficulty in predicting which eligible employees will opt for an early retirement package. As Cameron (1994) noticed, it is impossible to predict what important knowledge, “institutional memory,” and critical skills the organization will lose when employees separate under early retirement programs. This problem arises when early retirement incentive programs are offered to groups of employees and not targeted to individuals.

It is possible to limit the scope of early retirement incentive programs by offering incentives according to the age, labor union, or level of the employees. However, all employees composing such groups are free to accept or decline an offer. In many cases, it is impossible to make an early retirement offer only to those employees that an organization would prefer to have retired, without offering the same retirement opportunity to employees that it wants to retain. It is not legal to force someone to stay in an organization and manipulate the scope of the offering to exclude the desirable employees. This type of manipulation may lead to very expensive lawsuits and/or negative publicity.

Therefore, compared to the layoffs, early retirement incentive programs are less focused, which leads to three possible negative outcomes, according to Davidson et al. (1996):

1. Too few people may choose to opt for early retirement incentive programs, resulting in low effectiveness of the programs as a cost-cutting initiative.

2. Too many people may choose to opt for early retirement incentive programs resulting in unintended shortfalls in work force.

3. The “wrong” people may choose to opt for early retirement incentive programs—i.e., organizations may lose their most important and productive employees, while those whom a company wanted to leave may choose to stay.

Besides these three major issues, there is also another element that is difficult to estimate. There are always a certain percentage of employees close to retirement age, who could have retired soon anyway, and the organization would not have to pay them costly incentives if the early retirement incentive program was not offered (Hawthorne, 1993). Although these unanticipated additional costs should be considered, the major problems with early retirement incentive programs for the organizations are their potential ineffectiveness, loss of excessive numbers, and the loss of productive and experienced employees.

If an early retirement incentive program was ineffective and too few employees accepted the offering, a company may still be forced to resort to layoffs (Hawthorne, 1993). This was the case for Miller Brewing Company’s early retirement incentive program announced in 1992. It was accepted by only 82 employees. Management, in order to reach the payroll-cutting target, had to resort to layoffs and terminating a contract with 340 employees. Accordingly, time and costs expenditures associated with the program announcement resulted in a small return in terms of payroll-cost savings.

However, it is more dangerous for an organization to lose too many employees or to lose the “wrong” employees. This issue was addressed by Hawthorne (1993), who noted in one case that an early retirement incentive program is a failure if key employees or too many employees leave. A company is likely to spend significant time and money replacing key staff members or even rehiring some of the retirees. For example, when Du Pont announced an early retirement incentive program designed to reduce the number of employees by approximately 6,500, the offer was accepted by twice that number, leading to significant employee replacement cost (Appelbaum et al., 1987). Hitt et al. (1994) also considered early retirement incentive plans to be an ineffective downsizing practice, as they often result in a loss of valuable employees who possess important skills required for the organization’s current and future operations. Paul and Townsend (1992) found that the most creative, productive and risk-oriented employees frequently accept early

retirement incentive offers. The company loses employees who possess the key organizational qualities while employees who understand their inability to compete outside the organization prefer to stay. Due to lack of focus and planning, voluntary downsizing strategies such as early retirement incentive programs, represent a reactive rather than proactive human capital management strategy.

Mabert and Schmenner in 1997 surveyed managers with respect to their preferences toward downsizing strategies. They found that the majority of managers favored non-voluntary programs (i.e., layoffs) that are designed to determine which employees will be targeted for dismissal in advance. The majority of surveyed managers disregarded voluntary programs (such as early retirement incentive programs) because they target groups and allow anyone in the targeted group to leave a company, which may result in many negative outcomes.

According to this study, management reported that voluntary programs often become oversubscribed, create higher costs, and allow valued employees to resign, resulting in significant costs related to replacement and training. Moreover, according to several studies (Cyr, 1996; Heenan, 1989; Tomasko, 1991), institutional memory or specific knowledge and skills are not readily available on the labor market and/or their development among young employees is impossible or impractical. Accordingly, the companies may be forced to bring back retirees as independent consultants or buy services from external consultants in order maintain productivity. Therefore, payroll cost-cutting achieved through early retirement incentive programs is offset by costs associated with hiring consultants. This type of strategy may vary from case to case and therefore, benefits are highly debatable and are often reactive rather than proactive as a management strategy.

5. Factors Influencing Early Retirement Decisions

To reduce uncertainty stemming from a lack of focus in early retirement incentive programs and to reduce negative consequences, a number of studies were performed to gain insight into factors that influence decisions to accept or reject an early retirement offer. Naturally, a decision to opt for early retirement is very personal and very complex in nature, making precise predictions difficult.

Often, managers consider the decision to accept an early retirement offers to be solely a financial decision and believe that financial attractiveness is the only attribute determining the rate of acceptance. However, according to Feldman (1994), there are fundamental shifts in factors relating to family, organization, and environment, which make the early retirement decisions much more complex. Moreover, the same factors may have different effect in different situations. As Feldman (1994) noted, the same factor may pull to leave poor-performers and in other cases will have no association with performance. A number of studies, such as Feldman (1994), Kim and Feldman (1998), and Paul and Townsend (1992), attempted to determine factors or set of circumstances influencing the decision to opt for an offered early retirement incentive. All of these studies came to the conclusion that there are no direct answers, as this issue is very complex, and suggested a number of factors that affect such decisions (rather than determine them). The factors influencing decision according to these studies are as follows:

1. Age*:* Age is positively correlated with positive decision regarding early retirement.

2. Health*:* Poor health increases the likelihood of an early retirement offer acceptance.

3. Longevity of employment with the organization: The longer an employee has worked for a single organization, the higher the chances that he or she would choose to opt for an early retirement offer.

4. Performance/skills dynamics: Individuals who feel that their professional skills or performance are declining are more likely to accept an early retirement offer.

5. Spouse's employment: Individuals who have working spouses are more likely to opt for an early retirement offer.

6. Minor children: Employees with minor children are less likely to opt for an early retirement offer.

7. Association between self-identity and organization: If an individual has a strong bond between self-identity and the organization he or she works for, it is less likely they will opt for an early retirement offer.

8. Temperament: Aggressive, impatient and hard-driven individuals are less likely to accept an early retirement offer.

9. Retirement planning and pre-retirement counseling: Individuals who have planned their retirement beforehand or received pre-retirement counseling are more likely to opt for an early retirement offer.

10. Wages and future pension benefits: Individuals who have higher wages and prospective pension benefits are more likely to take the early retirement offer.

11. Perceived new employment opportunities: Individuals who feel confident about their ability to find a new job are more likely to opt for an early retirement offer.

12. Macro-economic trends perception: Individuals who feel uncertainty regarding future macro-economic trends (e.g., those who might worry about the state of the economy) are less likely to opt for an early retirement offer.

A review of this list clearly shows that many elements relate to personal perceptions, which may vary greatly from individual to individual, making prediction very complex. For example, many individuals of preretirement age consider retirement as an end of active and/or productive life; therefore, they attempt to postpone it as long as possible, while others consider retirement to be a release from lifelong onerous routine, enabling them to spend more time with friends and relatives and devote time to their interests and hobbies (Feldman, 1994).

Some of the following factors, when taken together, may have an opposite effect:

1. It is posited that employees with significant years of employment with a single organization are more likely to retire early and at the same time are also likely to have high pension benefits and personal savings. This increases the likelihood that they will accept the offering. On the other hand, these individuals are likely to have a strong bond between self identity with their job or organization, which has an opposite effect on their willingness to accept early retirement offer.

2. It is also posited that married employees are more likely to accept an early retirement offer; however, it is not uncommon for couples of preretirement age to have young children, which influences them to reject an early retirement offer.

3. It is also posited that poor performers or employees with declining performance are more likely to accept an offer; however, declining performance should reduce their confidence in post-retirement employment opportunities and, therefore, they might be inclined to stay with the organization.

Therefore, the multitude of factors, including psychological, physical, and family issues, job-related, financial, macroeconomics, governmental politics and others, influence an employee's decision to accept or reject an early retirement offer. These complex factors require sophisticated planning to ensure successful and focused early retirement incentive programs.

III. METHODOLOGY

The purpose of this research is to answer the following three research questions:

1. What are the ramifications of financial risks in terms of human resources financial costs when firms utilize early retirement strategies?
2. Are early retirement incentive strategies the most effective way to regain financial stability?
3. Who benefits more from early retirement strategies, management or employees?

In order to address these questions, desk research was selected as the primary methodology. Desk research will be based on the secondary data and analyses from miscellaneous publications related to the research questions, such as journal articles, books, surveys and other publication. Relevant information for each of the research questions will be provided, analyzed and conclusion will be drawn in Chapter IV:

Section A: Early retirement incentives: costs and risks

Section B: Corporate financial stability analysis

Section C: Advantages and disadvantages of early retirement implementation

Based on the analysis performed, conclusions regarding early retirement incentives efficacy will be drawn and summarized in concluding section.

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IV EARLY RETIREMENT INCENTIVES ANALYSIS

Companies implementing retirement incentive strategies have suffered various unintended consequences resulting from the incentive buy-out program. The following analysis presents data on unintended consequences (e.g., litigation by disgruntled employees who missed or were not offered incentives and workforce paranoia on job security).

A. EARLY RETIREMENT INCENTIVES: COSTS AND RISKS

To effectively address the research question "What are the ramifications of financial risks in terms of human resources financial costs when firms utilize early retirement strategies?" financial implications will be reviewed. Those implications include direct costs and savings resulting from early retirement incentive programs, as well as indirect and unanticipated financial ramifications.

1. Financial Implications: Savings and Direct Costs

The most obvious financial risk related to early retirement incentives implementation is that expenditures for those programs will outweigh the actual savings.

It is important to note that cost and savings greatly depend on the structure of the targeted group. Factors such as age, salary, and anticipated benefits should be proposed to make the offer lucrative. In case the targeted group has a homogeneous structure, accurate prediction of the offer acceptance rate will result in a reasonable estimate of the costs and savings. However, in cases where the targeted group is comprised of employees with substantial differences in salary and benefits, an accurate estimate of program outcomes can be challenging.

Calculating the savings resulting from early retirement incentive programs is much more straightforward compared to forecasting its costs. Savings are usually the amount of salary and related taxes anticipated from the early retirements. Additional savings may result from reduction of required working space, office supplies expenditures, and other minor savings.

Direct expenditures related to the implementation of early retirement incentive programs fall into two broad categories: replacement costs and program (or offering) costs (Hayden & Pfadenhauer, 2005). Replacement costs are comprised of estimated costs of hiring and training new (less costly) full-time or part-time employees or outsourcing services as a result of the retirement of targeted employees. As noted earlier, it is hard to predict the number of employees who will choose to retire, and the loss of organizational knowledge and skills within the organization. Accordingly, accuracy of replacement cost estimation may vary greatly.

Program or offering costs also include miscellaneous payments to the resigning/retiring employees as well as project expenses such as pension actuarial and attorney fees. The nature of payments and their calculation depends on the type of pension plan: defined benefit or defined contribution plan. One of the major challenges for designing an efficient early retirement offering is finding a fine balance between offering cost minimization and its anticipated return on investment, which influences subscription levels.

2. Early Retirement Incentives Costs in Defined Benefit Plans

In organizations that utilize defined benefit pension plans, employees who retire are guaranteed an annual pension, generally calculated on their salaries and years of service (Doerpinghaus & Feldman, 2001). Usually, employees have to be vested (that is, have worked for the same company) for five years to be eligible for pension benefits. Illustrative of defined benefit calculation formulae is the following organizational policy: Annual Pension Benefit = Average of Three Highest Years of Salary x 2% x Years of Service.

In many defined benefit pension plans, there are also penalties associated with “early retirement” (Doerpinghaus & Feldman, 2001). That is, if employees retire before they have accrued 30 years of service or before they reach 65 years of age, organizations with defined benefit pension plans usually penalize their pension benefits. In general, retirees’ pension benefits in U.S. are decreased by approximately 3%–5% for every year under age 65 or below 30 years of service they retire (Doerpinghaus & Feldman, 2001).

To make an ERI attractive enough to incentivize poorer performers to leave, organizations may have to offer very lucrative incentives. Unfortunately, those same incentives—when calculated on base salary—may incentivize better performers (and, presumably, the higher-paid employees) to leave as well. Organizations sometimes offer older workers lump-sum payments as inducements to accept an early retirement. Usually, these lump sum payments are based on some percentage of salary (often in the 5%–10% range) or on number of years of service with the company (e.g., 13 weeks' pay for 26 years of service). While lump-sum payments are occasionally offered as the sole incentive for early retirement, in defined benefit pension plans they are almost always offered in addition to some type of increase in long-term pension benefits as well.

For those organizations with well-defined retirement plans, the major inducement for older workers to retire is to increase the size of long-term pension benefits (Blinder, Gordon, & Wise, 1980). To do so, firms usually alter the ways in which pension benefits are calculated to increase potential retirees' future earnings. In most cases, these increases of long-term pension benefits are based on years of service, chronological age, or salary component.

- Years of service. Using years of service implies adding years of service in calculating pension benefits to eligible employees to reduce or eliminate any early retirement penalty (Doerpinghaus & Feldman. 2001). Rather than increasing years of service, other organizations have decreased penalties for older workers who are leaving before attaining eligibility for full pension benefits. Rather than recalculating pensions as if older employees had worked more years, organizations simply don't impose penalties for early departure.
- Chronological Age. In some organizations with defined benefit pension plans (many in the public sector), employees are allowed to retire with full benefits when they reach *either* 30 years of service *or* age 65. Analogous to the discussion above, organizations can create incentives for older workers to retire by adding some number of years (typically 3–5) to their chronological age in calculating pension benefits (Kim & Feldman, 2000,

1998). Here, too, it is possible to eliminate penalties for retiring before age 65 rather than adding years of chronological age to the pension benefit calculation.

- Salary Component. By and large, most organizations use a figure of close to 2% of salary per year of service in calculating pension benefits. At a time when most people retired at age 65 and counted on Social Security as an important source of income, workers could retire comfortably on 60% or so of their salaries. With a decrease in taxable income and the addition of tax-free Social Security and Medicare benefits, older workers could basically retire at the same level of after-tax income (Burtless & Moffitt, 1985; Clark & McDermed, 1986).

3. Early Retirement Incentives Costs in Defined Contribution Plans

In defined contribution retirement plans, the financial commitment of the organization to employees is depositing a prescribed percentage of annual salary into each worker’s tax-deferred pension fund and delegating control for the management of those funds to individual employees themselves. For example, under a defined contribution plan, a company might deposit 5% of annual salary into Employee A’s pension fund. From that point on, Employee A is responsible for saving or investing those pension funds. The range of annual pension contributions is generally between 5% and 15% of salary, depending upon the skill-level of employees, standards in the industry, or norms in the occupation (Doerpinghaus & Feldman, 2001).

In this case, the older employees’ ability to afford early retirement is under their control (depending on their investment decisions) rather than the organization’s control. Moreover, the organization’s liability for pension funding ends with the deposit into individual employees’ pension funds. The organization is not responsible for implementing or administering any kind of company-run pension plan.

For a variety of reasons, the amount of research on early retirement incentive plans in defined contribution pension plans has been more limited than in defined benefit plans. Compared with defined benefit plans, defined contribution plans are newer in origin and have not been as widely used.

While lump-sum payments may not be the central component of early retirement incentives in defined benefit plans, they are pivotal to defined contribution plans. In defined contribution plans, the amount of the pension benefit will be the result of the employee's own investment decisions. Consequently, one major financial inducement a defined contribution organization has to entice older workers to retire is adding a significant lump-sum payment to the employee's retirement account (either given at one point in time or distributed over a 1–3 year period).

In some cases, these payments will be in the form of cash (often as a percentage or multiple of annual salary); in other cases, these payments will be made in the form of stock ownership annuities or deferred stock options. In all these cases, though, the aim is the same: to give older workers sufficient assets to generate a stream of income great enough to sustain them in early retirement (Godofsky, 1988).

4. Unanticipated Financial Ramifications

Besides the fact that immediate financial effect of early retirement incentive programs is difficult for precise estimation, there are numerous ramifications, which are even vaguer. Such ramifications may include:

• Loss of production capacity due to oversubscription to the program.

• Decline in efficiency due to adverse changes in top performers/underperformers ratio (i.e., when too many underperformers choose to stay, while good performers opt to leave) or a loss of workers who possessed valuable knowledge or skills.

• Additional expenditures in order to correct negative effects of previous two points (hiring new employees, rehiring retirees, hiring external consultants and trainers, etc.).

• Litigation costs resulting from lawsuits filed by current or prior employees.

• "Free rider" expenses. Some of the employees may have intentions to resign or retire from the company without the early retirement offering, which does not result in

any costs for the company. However, when early retirement incentive programs are announced, such an employee may take advantage of it, which ultimately results in additional costs for the company.

Many authors (e.g., Appelbaum et al., 1987; Hawthorne; 1993; Hitt et al., 1994; Davidson et al., 1996) emphasized that, lack of focus early retirement incentives leads to excessive loss of workers and, more importantly, loss of the “wrong workers.” Under the loss of “wrong workers,” they implied loss of most productive workers or workers possessing valuable characteristics, instead of underperformers.

Litigation costs may also vary greatly and their occurrence, and negative implications are also quite complex in estimation. Reasons behind these lawsuits but may include:

• Prior employees who choose to retire early when early retirement incentive programs and corresponding benefits were unavailable may feel circumvented.

• Prior employees who choose to retire early under prior early retirement programs may also feel they were circumvented in a case more beneficial program is announced at a later date.

• Employees may be insulted if they feel that they are forced to accept an early retirement offer (Snarr, 1995).

• At the same time, some of the employees, which are eager to retire early, may be not eligible to apply for the program due to its limited scope and therefore feel being circumvented as well.

Organizations often underestimate their costs of their early retirement incentives by failing to consider the “free rider” expenses. In any given year, a certain percentage of older workers will retire whether they are given any additional incentives or not; hence, they will be doubly rewarded for a behavior they would have engaged in anyway. While organizations can never avoid “free rider” costs, ignoring those leads to overestimates of the effect of a specific early retirement incentives and underestimates its costs.

5. Conclusions

Immediate financial implications of early retirement incentives are savings on payroll with fewer benefits paid to retirees and direct expenses related to running the program. However, as early retirement incentives lack focus and their acceptance is a complex individual decision, it may be difficult to accurately predict their financial implications. Moreover, early retirement incentive programs may result in a number of unintended financial consequences, such as additional expenditures (e.g. rehiring, consulting fees, litigation costs) or loss of opportunities (e.g. "free riders," reduced capacity). These implications may totally offset savings achieved, and their estimate is even more challenging than the estimation of direct financial implications.

B. CORPORATE FINANCIAL STABILITY ANALYSIS

In order to address the research question "Are early retirement incentive strategies the most effective way to regain financial stability?" the term "financial stability" will be defined. Then options to regain stability, including early retirement incentives and other downsizing strategies, will be reviewed and compared.

1. Financial Stability Definition, Instability and Distress

In order to provide information for investment, strategic and operational decisions, financial analysis focuses on three basic measurements: Liquidity, solvency and profitability. These three components, according to the Chartered Financial Analyst (CFA) Institute (2008) may be defined as follows:

- Liquidity is a company's ability to meet its short-term obligations.
- Solvency (Leverage) is a company's ability to meet its long-term obligations.
- Profitability is a company's ability to generate profit from its assets.

Both liquidity and solvency are based on the company's balance sheet (sometimes on off-balance sheet listing assets and liabilities), based on a company's financial

position. Liquidity focuses on short-term, while solvency focuses on the long run, and both of them depend on profitability. Profitability is based on income statement and comprised of incomes offset by expenses.

All these components are interrelated. Borrowings and profitability influence the company's liquidity. Through borrowings and positive cash flow resulting from profitable operations, a company is able to settle its current obligations and fund operations costs (purchases, salaries, etc.). Borrowings increase the company's future obligations, affecting its solvency. The company is solvent only if it possesses sufficient assets and profitability to settle these obligations in the long term.

In cases where a company cannot generate sufficient cash flow, or loses its assets (e.g., its account receivable became uncollectible) or access to debt financing (e.g., cannot refinance its current debt), it may become illiquid. Illiquidity results in an inability to meet its current obligations and finance operations resulting in a downturn in operations. Accordingly, a downturn in operations is likely to affect the company's profitability, as certain portions of expenses are usually fixed and do not reduce proportionately to the decrease in sales. Decline in profitability, in turn, affects the company's liquidity in the short term and solvency in the long term.

Therefore, financial stability can be defined as ability to retain sufficient profitability, liquidity and solvency in the long run. It is important to note "long run" means not only maintaining an adequate financial position and performance in a stable or growing economy, but also an ability to withstand a certain amount of possible negative impacts. These negative impacts may vary depending on the nature of business and its operational model. Examples of risks that a company may face are: market access problems, disruption in operations, debt financing availability, fluctuations of prices on resources and produced goods/services, exchange rates, interest rates, overall market activity, competition, and natural disasters. Therefore, financial stability can be considered to be a financial position and performance, which enables achieving strategic objectives despite possible negative impacts on business.

A company may lose its financial stability by a number of external and internal factors. Internal factors may be the loss of competitive advantage (e.g., product appeal,

quality, price, marketing), poor financial planning, asset efficiency and fraud. External factors may include negative market shifts (decline in demand, strong competition, prices decline), negative fluctuations on financial market (unfavorable exchange rate fluctuations, growing, interest rates, unavailability of financing, etc), and natural and anthropogenic disasters.

There is no question that the current recession caused significant financial instability in many private companies. Most of them suffered from one or several of the following reasons:

- Quick deleveraging: In some cases, due to financial crisis, banks were not able to refinance existing debts upon their maturity to the companies. In other cases, banks were not inclined to refinance existing debts due to negative expectations towards companies' financial performances and positions.
- Decline in customer demand: Due to lack of cash and/or negative expectations, consumption and demand declined, applying market pressure for price decreases.
- Uncollectible trade accounts: Customers' financial distress resulted in their inability to pay invoices. Many were forced into bankruptcy, leaving companies no recourse for collecting debts owed.
- Growth in interest rates: Cheap credit during prior decades resulted in high leverage of many companies and recent growth of the interest rates resulted in financing expenses exceeding earnings.

All of these factors resulted in the decline of liquidity. Low liquidity and decline in customer demand, combined with market-driven price reductions, resulted in profitability reduction, which threatened the solvency of the companies.

Prolonged financial instability results in the distress of a company. Opler and Titman (1994) defined financial distress as the non-sporadic situation wherein a company is incapable of meeting its obligations when they become due. A distressed companies experience significant problems with settling obligations that become due or even break commitments, for example, refusing to settle obligations on their maturity. Wruck (1990),

Asquith et al. (1994), and Whitaker (1999) proposed similar definitions emphasizing the critical point when a company's EBITDA (earnings before interests, taxes, depreciation and amortization) is smaller than its interest expenses and operating cash flows are insufficient to satisfy current obligations.

According to Pindado and Rodrigues (2004), financial distress may result in multiple outcomes including bankruptcy and liquidation. Even when a company tries to overcome distress, it usually suffers substantial losses (Warner, 1977; Andrade & Kaplan, 1998).

2. Regaining Financial Stability Options

In order to overcome distress and regain financial stability, a company needs to restore its liquidity and profitability through any one or a combination of operating and financing solutions. Operating solutions include reducing costs and increasing sales (increasing volume of sales, prices or both). Financing solutions include decreasing capital and R&D expenditures, sale of the assets, obtaining debt or equity financing, debt restructuring, and mergers.

Deloitte, a credible strategy consulting firm, says underperforming companies:

> … typically should focus on operational and financial initiatives that can help them improve performance. These might include tactical efforts to lean out operations, shift fixed costs to variable, simplify business models, generate and conserve cash, optimize working capital, or divest non-core operations through outsourcing or other methods. As troubled companies approach a crisis or reorganization mode, their strategic actions will shift—requiring negotiations with suppliers and creditors in an attempt to influence outcomes, development of bankruptcy contingency plans, or steps to secure Debtor-in-Possession (DIP) financing. (Deloitte Development, 2009)

McKinsey, one of the most credible strategic consulting firms, conducted a Global Economic Conditions Survey in September 2009. Responses were received from 1,677 executives, representing "all regions, industries, company sizes, and functional specialties" (McKinsey, 2009). Respondents of the survey were questioned about their top priorities with respect to global crisis and top priorities related to regaining stability and insuring future growth. The results of this research survey are depicted in Figure 1.

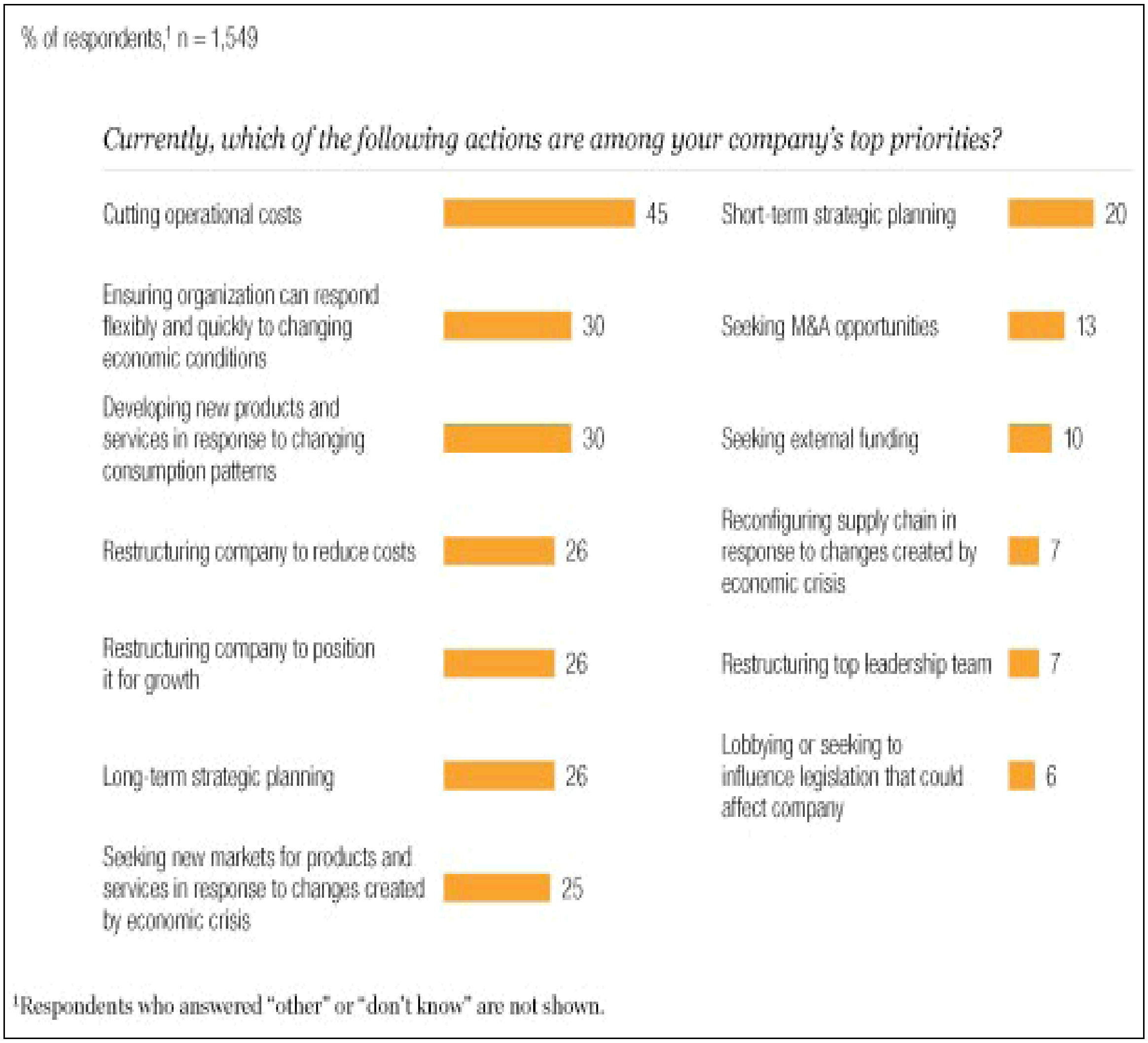

Figure 1. Priorities (From: McKinsey, 2009)

The research by McKinsey (Figure 1), indicates that the current top priorities of the surveyed companies is a mix of short- and long-term solutions, including cutting costs, developing new products, and working to ensure that organizations are flexible enough to respond to changing economic conditions. Three quarters of the respondents' companies are focused on cutting costs and restructuring to reduce costs. Approximately half of the respondents plan to reduce workforce in the next 6 months in order to reduce costs, while one quarter plan to increase workforce to support growth.

It is neither possible nor practical to compare all of the alternatives considered by companies to regain stability. Each particular case may have differences in the interests

of stakeholders, specifics of the country, industry or market, various economic limitations and multitude of other factors. These differences may affect both availability of such options to a particular company and outcomes of their selection. Moreover, in many cases, these options are not mutually exclusive and a combination of them may be used.

Pros and cons for early retirement incentives should be reviewed in comparison to other human resources cost-cutting alternatives, considering their impact on other options. With respect to reducing operating costs related to human capital, a firm will usually have the following options:

- Voluntary Unpaid Leaves and Sabbaticals. Companies may offer sabbaticals and additional leave options with considerably reduced, or eliminate compensation. Offering unpaid leave and sabbaticals may reduce costs during a downturn (Gandolfi, 2008). At the same time, this approach allows the companies to preserve employees, as they are likely to appreciate the reaffirmed job security (Vernon, 2003). However, most valuable employees may choose to change employers with this option.
- Reduced workweek and temporary shutdowns. A reduction from 40 to 35 or fewer hours week or a temporary facility shutdown is an effective cost reduction alternative during downturn. South Carolina's Nucor Steel Corporation avoided layoffs for 35 years by resorting to two- and three-day workweeks during downturns (George, 2004). Many employees are likely to appreciate more free time, but in many cases a reduced paycheck may affect loyalty. Nevertheless, in circumstances of unemployment growth, workweek reduction would likely be preferable to layoffs. Another negative implication is that workload may remain the same, despite reduced paid hours (Gandolfi, 2008).
- Cut In Overtime Pay. Abolishing or significantly reducing overtime pay can be a powerful technique in cost reduction in companies with significant overtime usage (Vernon, 2003). A company may choose the size of the overtime cut for each category of employees (Gandolfi, 2008). In 2004, GM, Ford, and car-supplier Visteon Corporation, slashed

overtime pay for most employees indefinitely (Dybis & Garsten, 2004). However, such a reduction in overall wages may discourage valuable employees from performing at a sufficient level and therefore reduce efficiency and output.

- Salaries and/or benefits reduction. Reducing benefits or salaries is one of the commonly used practices for firms experiencing financial pressure but wanting to avoid layoffs. Salary reductions may be temporary or extended. Whereas salary reductions mitigate financial concerns in the short run, extended salary reductions can negatively affect employee morale and loyalty. Nevertheless, employees typically prefer a temporary situation with smaller income than a permanent loss of their jobs. While companywide salary reductions prevent layoffs, top performers may be tempted to leave for competitors (Gandolfi, 2008). Firms may be creative in the application of salary and benefits, compensating reduced wages with company shares, future bonuses, or other types of performance-based variable benefits. This method is also focused, allowing targeted employees to be dismissed according to their efficiency and a company's strategic plans.

Nevertheless, firms forced to resort to layoffs have often report mixed results. There is a significant amount of empirical evidence that strategies do not automatically translate into improved organizational performance (Littler, 1998 & Macky, 2004) and have significant secondary consequences (Gandolfi, 2006). Besides severance payments, which partially diminish cost reduction achieved, decrease in production capacity and deteriorated morale may completely offset savings and hinder future growth. Many authors suggest that downsizing strategies should always be an absolute last resort (Macky 2004 & Gandolfi, 2007), when layoffs are desirable, warranted, or unavoidable.

The Table 1 summarizes key strengths, weaknesses, opportunities and threats of each payroll cost reduction initiative.

Table 1. Strengths, weaknesses, opportunities and threats

Payroll cost reduction initiative	**Internal**		**External**	
	Strengths	**Weaknesses**	**Opportunities**	**Threats**
Layoffs	Focused Significant payroll cost reductions possible	Negative perception Severance payments Decrease in production capacity		Loss of loyalty and moral
Early retirement incentives	Lower impact on moral of remaining personnel due to voluntary nature May result in sufficient cost savings	Unfocused Benefit payments Hard to estimate outcomes Decrease in production capacity	Promoting young talent	Excessive downsizing Insufficient downsizing Loss of valuable employees
Benefits and/or salary reductions	Significant payroll cost reduction possible Focused	Negative perception	May be used creatively	Loss of loyalty and moral Clashes with trade unions
Cut in overtime pay	Significant payroll cost reductions possible	Not efficient in organizations with low overtimes		Discouraging overtime work may affect performance in industries where overtimes are necessary
Reduced workweek and temporary facility shutdown	Medium to significant payroll cost reductions No need to reduce headcount	May not correspond to workload level Loss of output	Increase of free time may be positively accepted by the employees	Effective payroll reduction may result in loss of loyalty and moral Clashes with trade unions

3. Conclusions

In general, voluntary measures are less focused as compared to involuntary and therefore have less predictable outcomes. Although involuntary measures may produce more predictable outcomes, they may have negative impact on morale of the remaining employees and decrease their productivity. For example, payroll cost reduction solutions that ultimately decrease employees' incomes (such as benefits and salary reduction, overtime pay reduction, workweek reduction, etc.) facilitates accurate savings estimates more precisely and in many cases may provide sufficient economy. However, in most cases, these solutions have negative impact on morale and strongly encourage top performers to leave. Cost reduction through employment termination (both voluntary and involuntary) also facilitates significant savings, but headcount reduction may hinder future growth or result in high future hiring and rehiring costs.

Early retirement incentives, compared to other strategies, may have significant payroll costs reduction potential (depending on the age and structure of the company). However, due to their lack of focus, they may result in opposite outcomes—excessive on headcount reduction, which diminishes capacity and hinder growth, or insufficient headcount reduction, which does not provide sufficient savings. In both cases, the most valuable workers may be among employees who opt to leave. Such variability of the outcomes implies that implementing early retirement incentives requires the most elaborate planning and execution in order to be effective, predictable and safe.

C. ADVANTAGES AND DISADVANTAGES OF EARLY RETIREMENT IMPLEMENTATION

In order to address the research question "Who benefits more from early retirement strategies, management or employees?" advantages and disadvantages of accepting early retirement offering for both, employers and employees, are present in Table 2.

Table 2. Advantages and disadvantages

	Advantages	Disadvantages
Company	Cost reduction Less harsh cost-cutting option as compared to layoffs Aligning remunerations to performance Improving career opportunities and motivation for younger employees Costs associated to early retirement may be charged to pension funds	Vague financial outcomes May result in excessive loss of workers May result in adverse shift in underperformers/top performers ratio. "Free riders" expenses
Employee	Release from onerous (from standpoint of health, time, mental or physical efforts) work Humane alternative to termination Financial benefits (especially for "free riders")	Depression related to perceived end of active life Self-image impairment. End of career Financial encumbrance Financial security impairment

Advantages and disadvantages for both employees and employers may be contradictory, which demonstrates the complex nature of the early retirement incentives. For example, a retired person can feel relief due to reduction of mental efforts and time spent at work, but at the same time, may experience psychological problems due to abolishing such activities. Similarly, a company may benefit from expenditures decrease, but its growth may be hindered due to loss of certain employees.

1. Early Retirement Incentives Advantages and Disadvantages: Employers

For employers, major advantages of early retirement incentives are cost reductions using a voluntary approach and demographical change in workforce. Not only are younger employees likely to be cheaper, but other positive changes for management

are possible. For example, Adams (1999) claims that rather than attempting to change the attitudes and beliefs of long-time employees, firms may find that early retirement incentives are more instrumental in increasing morale and changing the company's core values. Nevertheless, a lack of focus and the voluntary nature of early retirement incentive programs may result in adverse results as discussed earlier.

2. Early Retirement Incentives Advantages and Disadvantages: Employees

For employees, variability of advantageous and disadvantageous effects of early retirement incentives may vary greatly even within the same company, depending on personal factors.

Intrinsic reasons, which usually induce employees to accept early retirement offers or even retire without early retirement incentive programs are usually as follows:

- Health and family issues. Often employees of preretirement age have a health condition, which makes employment impossible or burdensome, or further employment may become impossible due to necessity to care for a spouse (Feldman, 1994).
- Personal preferences. Some individuals of preretirement age, usually with sufficient savings, choose to spend more time with friends and relatives and to devote time to their interests and hobbies, rather than continue working (Feldman, 1994). One of the particular cases of personal preferences is the perception of early retirement as an alternative to termination. In some cases, a person of a preretirement age may understand that his or her deteriorating health and skills may result in termination (Paul & Townsend, 1992). In this case, early retirement incentive programs would be considered by such person to be a much more preferable option.

These two reasons may induce a person to retire early even without early retirement incentive programs. However, when they are insufficient to induce a person to retire early without any additional benefits, lucrative early retirement programs can influence a person's decision to opt for the retirement package. In cases where a person

decides to retire whether an early retirement incentive program is announced or not, they are very likely to seize corresponding benefits if they become eligible to participate in such programs (“Free riders”).

While health and family issues have quite straightforward connection with early retirement (poor health and need to devote time to family members increase probability of early retirement), personal preferences have much more complex nature. Many individuals of preretirement age consider retirement as an end of active and/or productive life and therefore attempt to postpone it as long as possible (Feldman, 1994). At the same time, others may consider an offer to retire early is an insult, conveying a message that they are not wanted in the company, which may, in case of strong bound between self-identity and a company, lead to severe self-identity crisis (Feldman, 1994; Paul & Townsend, 1992).

Health and family issues and personal preferences are basic intrinsic reasons behind early retirement; however, they may be outweighed by a number of perceived negative factors among which are perceived financial disadvantages and reemployment encumbrance play the key role.

Besides negative psychological effects, early retirement incentive programs may have financial disadvantages for the employee (Feldman, 1994). Despite receiving financial benefits under early retirement incentive and having certain pension savings, a person may find that he or she is incapable of maintaining a desired quality of life. While finding a new employment or starting one’s own business is always an option to improve wealth, in many cases it may be cumbersome (Minda, 1997). Despite anti-discrimination laws, seniors experience significant problems with re-employment (Minda, 1997), especially in times of recession and downturns.

Another disadvantage of early retirement incentives is related to their financial security. In most cases, a pension represents a fixed income, and individuals who live on fixed incomes are particularly vulnerable to equity and bond markets downturns. These concerns are particularly heightened today as a result of the current financial crisis. At the same time, other reasons for concern include the rising age or eligibility for “full” Social Security benefits, increased taxes on Social Security benefits, and the uncertain future of

the Social Security system itself. Retirees and other individuals living on fixed incomes are also especially vulnerable to sudden price increases in major goods and services. Of particular concern are the increases in the costs of health care, prescription drugs, and health insurance premiums. Fortunately, employees are legally guaranteed the right to remain in an organization's health insurance group for over a year after they retire; however, they are not guaranteed the right to continued organizational contributions to their health insurance premiums. As the costs of health care escalate, extended employee benefits in this area are likely to become an increasingly important factor in the acceptance of ERI packages (Cutler, 2001 & LaRock, 1999).

Some of the advantages and disadvantages of the early retirement incentives relate solely to personal perceptions, which may vary greatly from individual to individual. At the same time some of them are objective measures. Both categories may vary greatly from case to case, making mutually exclusive definitions of advantages and disadvantages of early retirement incentives impossible.

3. Conclusions

Factors influencing design and acceptance of early retirement incentives may vary greatly and so do their outcomes for both employees and employers. Therefore, it is impossible to conclusively determine who benefits more from early retirement incentive programs, a company or its employees.

In some cases, as a result of early retirement incentive program, a company may fail to achieve its strategic objectives, while retired employees will be fully satisfied by their retirement. In other cases, a company may achieve desired financial relief, but retired employees would face severe personal and financial problems. Both “win-win” and “lose-lose” scenarios are also possible, as well as mixed results where some of the parties are satisfied with outcomes and others are not.

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V. CONCLUSIONS AND RECOMMENDATIONS

In their search to regain stability, as well as simply to improve performance, companies utilize various operating and financing strategies. Among these strategies, an important role belongs to cost reduction initiatives. Many practitioners and researchers consider early retirement incentives to be a good alternative to layoffs for the purposes of cost reduction and operations streamlining. At the same time, many find early retirement incentives to be much less harsh than layoffs, reducing impact on morale of both leaving and remaining personnel, as well as of the decision-makers. Another perceived benefit of the early retirement incentives is the alignment of productivity with pay rates, by reducing the amount of lower-efficiency, higher-paid senior employees and improving career opportunities for younger, more productive employees. Despite outlined benefits of the early retirement incentives, such programs are widely criticized from different perspectives. Critics of early retirement incentives challenge their perceived benefits and provide evidence of their negative effects, both anticipated and unintended. The key focus of this paper is efficacy of early retirement incentives from the organizational strategy standpoint. In order to achieve this, the following research questions were addressed:

1. What are the ramifications of financial risks in terms of human resources and financial costs when firms utilize early retirement strategies?

2. Are early retirement incentive strategies the most effective way to regain financial stability?

3. Who benefits more from early retirement strategies, management or employees?

A. RAMIFICATIONS OF FINANCIAL RISKS IN TERMS OF HUMAN RESOURCES FINANCIAL COSTS

Financial implications of the early retirement incentives were analyzed. According to the research, direct costs associated with early retirement incentive programs represent a trade-off between reducing the program costs and increasing the appeal of the early retirement offering. In order to achieve target cost reductions,

offerings should be considerably lucrative. But at the same time, excessiveness of benefits proposed may result in less efficient cost reduction and raise other negative consequences. Negative consequences of the early retirement incentive programs, resulting in unanticipated loss, include:

- Loss of production capacity due to oversubscription to the program.
- Decline in efficiency due to adverse change in top-performers/underperformers ratio.
- Additional expenditures in order to correct negative effects of previous two points
- Litigation costs resulting from law suits filed by current or prior employees.
- "Free rider" expenses.

Besides the fact that immediate financial effects of early retirement incentive programs are difficult for precise estimation, unanticipated ramifications are even vaguer and may totally offset any financial value realized from early retirement incentive programs. It is easy to conclude that the risks associated with the implementation of early retirement programs, detailed earlier and summarized above, play a major role in the financial success or failure of an early retirement strategy.

B. EFFECTIVENESS FOR REGAINING FINANCIAL STABILITY

In order to overcome distress and regain financial stability, a company needs to restore its liquidity and profitability through combination of operating and financing solutions. Pros and cons for early retirement incentives were analyzed in comparison to other human resources cost-cutting alternatives, such as benefits and/or salary reductions, cuts in overtime pay, a reduced workweek and temporary facility shutdown, voluntary unpaid leaves and sabbaticals, and layoffs.

In general, voluntary measures are less focused and may result in the loss of the most effective employees, so the remaining workforce is less predictable. Involuntary measures may produce more predictable outcomes; however they still may affect productivity through deteriorating morale. Methods based on resignation (both voluntary

and involuntary) to reduce a company's headcount may hinder future growth or result in high future hiring and rehiring costs. Various types of benefits reduction may achieve cost reduction objectives without reduction of the headcount, but they may decrease performance and induce top performers to leave.

Early retirement incentives, as compared to other strategies, may have significant payroll costs reduction potential (depending on the age structure of the company). However, due to their lack of focus, they may result in opposite outcomes—excessive headcount reduction, which diminishes capacity and hinders growth, or insufficient headcount reduction, which does not provide sufficient savings. Therefore, implementing early retirement initiatives requires the most elaborate planning and execution in order to be effective, predictable and not deteriorate the potential of the firm.

C. BENEFITS FOR MANAGEMENT AND EMPLOYEES

According to the analysis conducted, advantages and disadvantages for both, employees and employers, may be contradictory, which demonstrates the complex nature of the early retirement incentives.

For the employers, major advantages of early retirement incentives are cost reductions with voluntary approach and demographic change in workforce. Not only are younger employees likely to be cheaper, but also may improve morale and make positive shifts in the company's culture. Nevertheless, the lack of focus and voluntary nature of early retirement incentive programs may result in multiple unintended, negative consequences and therefore pose serious challenges to managers.

For employees, many of the advantages and disadvantages of the early retirement incentives relate solely to their personal perceptions, which may vary greatly from individual to individual. These personal variations make mutually exclusive definitions of advantages and disadvantages of early retirement incentives impossible.

Review of advantages and disadvantages of early retirement incentives for both, employers and employees, drive to the conclusion that it is impossible to define who benefits more from early retirement incentive programs, a company or its employees. In some cases, as a result of an early retirement incentive program, a company may fail to achieve its strategic objectives, while retired employees will be fully satisfied by their

retirement. In other cases, a company may achieve desired financial relief, but retired employees would face severe personal and financial problems. Both “win-win” and “lose-lose” scenarios are also possible, as well as mixed results where some of the parties are satisfied with the outcomes and other are not.

D. BOTTOM LINE

Early retirement acceptance is a complex individual solution and in many cases, it is difficult for accurate prediction. Therefore, calculations of immediate financial effects of early retirement incentive programs are very challenging. Moreover, early retirement incentive programs may result in several unintended consequences, which may totally offset savings achieved.

Early retirement incentives, as compared to other strategies, may have significant payroll costs reduction potential. Due to their lack of focus, they may have various negative implications that must be carefully considered before the implementation of an early retirement strategy for employee reduction and realignment.

According to the researched information, factors influencing early retirement program design and acceptance may vary greatly, and so do their outcomes for both employees and employers. Therefore, it is impossible to conclusively determine who benefits more from early retirement incentive programs, a company or its employees.

An early retirement incentive is a complex management strategy, which may have mixed results, conceals many threats and requires elaborate analysis on a case-by-case basis. Such analysis should enable decision-makers to assess potential benefits of such programs, as well as associated risks, and compare them to alternative solutions. Early retirement incentives should not be used as a “quick and dirty” solution, but applied with sufficient care and consideration in order to avoid substantial unintended consequences.

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